Jack Ehnes
Chief Executive Officer

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October 11, 2018

Brent Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

RE: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation – File No. S7-09-18

Dear Mr. Fields:

The California State Teachers' Retirement System (CalSTRS) respectfully voices its full support for the Institutional Limited Partners Association's (ILPA) comments as submitted in their August 6, 2018, comment letter to the U.S. Securities and Exchange Commission (SEC or Commission) on the Proposed Interpretation Regarding Standard of Conduct for Investment Advisers (Proposed Interpretation).[1]

CalSTRS, a member of the ILPA, invests on behalf of California public school educators and is the second largest public pension fund in the United States, managing $227.6 billion in total assets. Nearly $18.5 billion of these assets are invested in the private equity market. CalSTRS serves more than 933,000 members and their families by providing retirement, disability, and survivor benefits.

CalSTRS supports the effort of the Commission to provide more clarity regarding the fiduciary duties owed by investment advisers to their clients under the Investment Advisers Act of 1940 (Advisers Act) and, in particular, around the duty of loyalty. Increasingly, we have grown concerned about the perceived contention that private fund advisers can "disclose away" their fiduciary duties, including significant conflicts of interest.

As a result, we were pleased to see that the SEC stated in the Proposed Interpretation that the disclosure of a conflict alone is not always sufficient to satisfy the investment adviser's duty of loyalty under the Advisers Act.[2] In particular, the following statement in the Proposed Interpretation makes clear that advisers cannot merely disclose away the intended fiduciary duties in the Advisers Act:

> [I]t would not be consistent with an adviser's fiduciary duty to infer or accept client consent to a conflict where either (i) the facts and circumstance indicate that the client did not understand the nature and import of the conflict, or (ii) the material facts concerning the conflict could not

[1] Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, SEC Rel. IA-4889, File No. S7-09-18 (April 18, 2018).
[2] *Id.* at 17.

> be fully and fairly disclosed…In other cases, disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive…In all of these cases where full and fair disclosure and informed consent is insufficient, we expect an adviser to eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed.[3]

We encourage the SEC to maintain this current standard in any final interpretation, in accordance with the plain meaning of the Advisers Act.

In addition, CalSTRS supports the ILPA proposal to rescind or carve out private equity from the Heitman Capital Management no-action letter issued by the SEC in 2007. The letter overturned a 67-year policy at the SEC that "hedge clauses" were a *per se* violation of the Advisers Act and permitted private fund advisers to diminish the fiduciary duties owed to their investors under the investment contracts they sign, such as limited partnership agreements (LPAs).[4] Fiduciary duties owed to private fund investors should be clear, and these changes have significantly reduced the obligations of a manager to act in the best interest of its investors. They have also created increased legal costs and uncertainty for both investment advisers and LPs in the private fund marketplace. We believe the SEC should rescind this no-action relief and return to considering the use of hedge clauses as *per se* violations of Sections 206(1) and (2) of the Advisers Act. At the minimum, the Commission should carve out private equity funds from the Heitman no-action letter given the lack of redemption rights in the private equity model.

The Chairman has issued recent statements indicating that certain staff guidance, including no-action letters, should not be considered law by regulated entities.[5] The Commission also recently rescinded two no-action letters in the proxy advisory space, suggesting there is precedent for revisiting policy decisions made as informal guidance in the past.[6] Therefore, there is no reason the Commission cannot act here to address the importance of strong fiduciary duties for private fund advisers in the marketplace.

CalSTRS appreciates the opportunity to share our views on these important issues. We look forward to meeting with the staff in person to share additional perspective on fiduciary duty in the private equity marketplace.

Sincerely,

Jack Ehnes
Chief Executive Officer

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[3] *Id.* at 18-19.
[4] Comment Letter from Steve Nelson, CEO, ILPA, to Brent Fields, Secretary, SEC (August 6, 2018), available at: https://www.sec.gov/comments/s7-09-18/s70918-4173955-172347.pdf.
[5] *Statement Regarding Staff Proxy Advisory Letters*, SEC Public Statement (September 13, 2018), available at: https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters.
[6] *Statement Regarding SEC Staff Views*, SEC Public Statement (September 13, 2018), available at: https://www.sec.gov/news/public-statement/statement-clayton-091318#_ftn2.